No. 14906

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

PUGET SOUND PULP AND TIMBER CO.,
a corporation,

Appellant,

vs.

JOE A. O'REILLY,

Appellee.

JOE A. O'REILLY,

Cross-Appellant,

vs.

PUGET SOUND PULP AND TIMBER CO.,
a corporation,

Cross-Appellee.

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

REPLY BRIEF OF APPELLANT BRIEF OF CROSS-APPELLEE

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REPLY BRIEF OF APPELLANT

STATEMENT OF THE CASE

Appellee's Breach of Contract

With respect to appellee's contention (Br. 1-2) that the organization of California Paperboard Cor-

poration by O'Reilly and its manufacture and sale of paperboard products would not be a breach of his contract with appellant, the record is clear that the activity contemplated by and actually carried on by O'Reilly amounted to a substantial breach of his contract. The agreement obligated O'Reilly not to "undertake or promote the sale or sales of like, similar or competing commodities . . ." (Ex. 3, Tr. 18).

By O'Reilly's own testimony, California Paperboard produced some products identical with those of appellant (Tr. 118-19). After one of appellant's customers invested $40,000 in California Paperboard to obtain "a second source of supply" for lettuce pads which had been obtained from appellant, O'Reilly solicited appellant's customer to divert orders from appellant to California Paperboard (Tr. 173, 182, 183).

The clearest evidence of O'Reilly's breach of the contract is contained, however, in his own letter of July 12, 1951, in which he wrote appellant's president in part as follows (Ex. A-1):

> "Customers, grades and areas have been selected to avoid a competitive impact when new production, either by Container's new Los Angeles machine or California Paperboard in Richmond, comes into the field. This is the result of advance planning going back to last fall and winter.
>
> * * *
>
> "We are not shipping very much to former

large California customers who will be customers of California Paperboard."

By his own admission O'Reilly, as early as the fall of 1950, was conducting appellant's sales program in a way to avoid "competitive impact" with his own mill when it began production.

Furthermore, appellant had the right under the contract to discharge appellee if his work was unsatisfactory at any time after May, 1949, even if the contract be held one for a five-year period (Ex. 3, Tr. 14, 15-16).

REPLY ARGUMENT ON SPECIFICATION OF ERROR NO. 1

Under this argument appellant contends that the trial court's Finding of Fact No. X that "plaintiff temporarily reduced his commission in December 1948 or January 1949 and postponed collection of the remainder" was clearly erroneous. Appellee's brief concedes that this finding is "a conclusion of mixed fact and law" (Br. 4) and that neither O'Reilly nor Roberge, the two parties to the conversation in which the reduction was discussed, used language of postponement. The "ultimate fact" that only the collection of the balance was to be postponed is claimed to be supported by record references. None of the record references cited by appellee contains any evidence which would support the finding that O'Reilly postponed collection of

the balance of 1½% of his commission. No permissible interpretation of appellee's words or conduct in any way supports this finding.

Appellee also attempts to discount O'Reilly's own testimony that the reduction would be "until the operations became profitable" as being "without legal significance" (Br. 4). Of course, O'Reilly's compensation was *measured* by sales and not by profit, but O'Reilly himself thought there was a sufficient relationship between his compensation and the profit or loss of the Paperboard Division to reduce his commissions until "the operations became profitable." (Tr. 97) In his letter of June 5, 1953, when he first disclosed his claim to recover additional compensation going back to January, 1949, he wrote as follows:

> "You may recall that I voluntarily suggested that I take 1½% or half of the agreed amount starting January 1, 1949, *'until the operation became profitable'*."
>
> "It is my considered opinion that your records, and/or an independent audit, will disclose the fact that the board mill operation was profitable for the major portion, if not all, of the time since that date."

Here was a clear admission by appellee that restoration of his commission rate was to begin only when and if the Paperboard Division became profitable. Appellant does not point to the absence of a profit by the board division either as consideration for O'Reilly's reduction or as an excuse for nonper-

formance of the agency agreement. It is relevant because by his own testimony it was a condition precedent to a restoration of his commission to 3%.

With respect to appellant's accounting procedures by which pulp was billed to the Paperboard Division at market price, the purpose was to determine whether appellant was making a profit through its paperboard operation (Tr. 262). This method of charging raw material was expressly provided and agreed upon between appellant and appellee in paragraph 9 of the original agreement (Ex. 1, Tr. 13).

With respect to the burden of proof on the issue of whether the Paperboard Division ever became profitable, that burden was clearly on appellee. The agreement for reduction was admitted and proven by appellant's testimony. Appellee clearly had the burden of proof to establish the condition which was to be precedent to a restoration of his commission rate. The issue is no different than it would have been if O'Reilly had pleaded the modified agreement, *i. e.,* had alleged, as he now claims, that his compensation from January, 1949, forward was to be at the rate of 1½% "until the operation became profitable," *whereupon* it would be raised *retroactively* to 3%. He is now attempting to recover without establishing the condition precedent to a restoration of his commission.

Not only did appellee make no effort to establish the happening of this condition precedent, but there is a clear inference from his own testimony that the

operation did not ever become profitable during O'Reilly's employment. O'Reilly himself knew that the operation was unprofitable in January, 1949 (Tr. 97). Throughout the remainder of his employment, O'Reilly, as manager of the Paperboard Division, was clearly in a position to know the financial aspects of its operations. He received monthly statements showing net sales (Ex. 11, Tr. 93-94). His first claim to commissions at the rate of 3% in lieu of 1½% from January, 1949 forward was made some two years after termination of his employment had been agreed upon (Ex. A-6). Even then, it was coupled with language showing his claim for additional compensation was contingent on a determination that the operation had become profitable, and was limited to periods in which it had been profitable.

The trial court's error and the fallacy of appellee's reasoning becomes more apparent when it is considered that O'Reilly himself testified that he was agreeable to receiving a 1½% commission for the month of January, 1949 (Tr. 109), a month for which the trial court awarded him an additional 1½%.

REPLY ARGUMENT ON SPECIFICATION OF ERROR NO. 2

Appellee's brief attempts to distinguish the nine cases cited by appellant in its original brief as es-

tablishing that no consideration is required for the modification of an existing executory contract. Appellee claims that these cases fall into two categories, holding as follows:

> 1. A contract can be modified without fresh consideration where there has been no substantial performance on either side; or
> 2. A contract can be modified where there has been partial performance and the parties agree to terminate or modify future performance on both sides.

Examination of the cases cited will not support appellee's attempted distinction.

Appellee suggests no reason in logic why a wholly executory contract can be modified without consideration but a partially executory contract cannot be. The cases make no such distinction. In fact in the first case claimed by appellee to come within the first category above, *Hunter's Cattle Co. v. Carstens' Packing Co.,* 129 Wash. 377, 225 Pac. 68 (1924), it is clear that performance had already begun at the time the parties modified their original agreement, by relieving one of the parties from compliance with one of its terms. As cited in appellant's original brief, the court said: (p. 379)

> "* * * while a contract remains executory in a substantial measure on both sides, an agreement to annul or modify on one side is a consideration for an agreement to annul or modify on the other side."

The cases of *Meyer v. Strom,* 37 Wn. (2d) 818, 226 P. (2d) 218 (1951), and *Neilson v. Northern Equity*

Corp., 147 Wash. Dec. 155, 286 P. (2d) 1034 (1955), expressly cite the *Hunter's* case. None of the cases relied on by appellant makes the distinction that a wholly executory contract, as distinguished from a partly executory one, can be modified without fresh consideration. The test set forth in the cases is whether the contract "remains executory in a substantial measure." At the time of the modification in this case clearly the contract remained "executory in a substantial measure."

With respect to cases cited by appellant and claimed by appellee (Br. 8) to stand for the proposition "that the release of the unperformed duties of the one party will support the release of the unperformed duties of the other," no reading of the leading Washington case of *LaPlante v. Hubbard,* 125 Wash. 621, 217 Pac. 20 (1923), will support appellee's analysis, and reference is made to the portions of that opinion set forth in the original brief at pages 20-21. Nor do the federal cases cited support appellee's position. In *Mid-State Products Co. v. Commodity Credit Corp.,* 196 F. (2d) 416 (7th Cir. 1952), plaintiff and defendant were parties to a fixed price contract for the sale of powdered eggs. The contracts were amended to provide for payment on a cost-plus basis, which materially reduced the seller's profit, while the seller remained obligated to deliver the contracted quantity, and did so. After the contract was fully performed, the seller

brought an action to recover on the original contract. Clearly, there had been no release of any unperformed duty on the part of seller. The court cited the Supreme Court decisions relied upon by appellant and its statement of the applicable law appears in appellant's original brief at page 25.

Appellee's brief (Br. 10-12) cites six Washington cases which are apparently claimed to hold that the binding modification of an executory agreement requires new consideration. At least, if the cases do not stand for that proposition, they are irrelevant and of no assistance to appellee.

While it might be sufficient to point out that all of appellee's cases precede the *Meyer* and *Neilson* decisions, *supra,* p. 7-8, it is submitted that they are in fact distinguishable.

Two of appellee's cases, *Allen v. Farmers & Merchants Bank,* 76 Wash. 351, 135 Pac. 621 (1913), and *Keane v. Fidelity Savings & Loan Association,* 173 Wash. 199, 22 P.(2d) 59 (1933) do not involve modification of a contract. The former concerns a parole agreement alleged to have been made *contemporaneously* with a written agreement. The latter involved a guaranty of payment by the promissor to induce the performance of the promissee's contract with a third party.

Mosher v. Mosher, 25 Wn. (2d) 778, 172 P. (2d) 259 (1946), does not involve an attempted modification of a contract, but a claim of an oral agreement

for the reduction of support payments provided by an Oregon divorce decree. The court stated that the obligation to pay a sum certain could not be discharged by payment of a lesser sum, but rested its decision on the finding that no such contract had been made, and that, in any event, the mother could not surrender rights conferred on the children by a court decree.

In the remaining cases, the party relying upon the original agreement had no further duties to perform before being entitled to performance from the party claiming a modification. In *Harris v. Morgensen,* 31 Wn. (2d) 228, 196 P. (2d) 317 (1948), plaintiff was in default under a lease and a contract of conditional sale, which entitled the defendants to retake the property and retain all prior payments. The plaintiff claimed the original contract had been modified, after default, by an agreement that the defendants would cancel plaintiff's indebtedness and refund the sum of $500.00 theretofore paid, and that plaintiff would surrender the property. Plaintiff claimed the surrender of the property constituted consideration for the agreement to refund $500.00. The court held the claimed modification void for want of consideration, because defendants were entitled to immediate possession, without further performance on their part.

So, in *Queen City Construction Co. v. Seattle,* 3 Wn. (2d) 6, 99 P. (2d) 407 (1940), and *Westland*

Construction Co. v. Chris Berg, Inc., 35 Wn. (2d) 824, 215 P. (2d) 683 (1950), the original agreement required the contractor to perform certain work, for a stated price. It was claimed that the original agreement was modified to provide extra compensation for work included in the original contract. The contractor was obligated to perform the work before being entitled to payment under the contract. It may also be noted that the latter case involved a wholly executory agreement, which, under appellee's view of the law (Br. 7-8), may be modified without fresh consideration.

Appellee's cases therefore establish no more than that, where one party to a contract is in default, or the time fixed by the contract for his performance has arrived, and the other party has fully performed, or is not obligated to perform until a later time, agreement by the latter to pay a larger sum for the contracted performance is void for want of consideration.

Other distinguishing factors were present. With the exception of the *Queen City* case, *supra,* testimony as to a modification was in dispute. In that case, the contractor received the additional compensation provided by the modification for all work performed from the time of the modification until it was notified by the City that the work was covered by the original contract and extra payment

would no longer be made. There was no claim by the City to recover payments made under the modification agreement, and the Court carefully pointed out that such a claim "would present an entirely different question." (3 Wn. (2d) at page 20)

The question not decided was one governed by prior and subsequent decisions of the Washington Supreme Court cited in appellant's original brief, pp. 34-37, which hold that where a modified agreement has been executed, it cannot be disturbed for want of consideration.

In contrast to appellee's cases, the instant case is one in which appellant was not in default under the original agreement at the time of the modification, and appellee and appellant had continuing mutual obligations. There was no modification as to past due commissions. The factual situation in the instant case is closely analogous to an illustration contained in the *Restatement of Contracts,* an authority frequently relied upon by the Washington Court. Section 416 states as follows:

> "Sec. 416. DISCHARGE OF DUTY TO RENDER RETURN PERFORMANCE BY MANIFESTATION OF ASSENT AT TIME OF PERFORMANCE.
>
> Where one party to a bilateral contract at the time when he renders performance manifests to the other party assent to forego all or part of the performance promised as an agreed exchange by the other party, the latter's duty is to that extent discharged."

Comment (c) thereunder is as follows:

"c. The act manifesting assent to discharge may be done at any time before performance, provided the effect of the act as a manifestation is continuing at the time of performance. Assent to discharge manifested after that time is not within the rule stated in the Section, and is generally inoperative unless supported by sufficient consideration (see Sec. 406). A party to a contract cannot increase his duty thereunder without fulfilling the requirements for the formation of contracts; but *either party can diminish the duty of the other party by manifesting an intent to do so on rendering his own performance.* Either party, moreover, can increase his own performance as much as he chooses, though he cannot enlarge his duty to render the increased performance. (Emphasis supplied)

Illustration 2 is squarely in point:

"2. A contracts to build a fence for B, who contracts to pay $500 therefor. A begins to build the fence and as he starts says to B, "That price we agreed on is too high, you need pay only $400 for the fence." A then completes the fence. B's duty is limited to the payment of $400."

Bellingham Securities Syndicate, Inc. v. Bellingham Coal Mines, Inc., 13 Wn. (2d) 370, 125 P. (2d) 668 (1942), and *Seattle Investors Syndicate v. West Dependable Stores,* 177 Wash. 125, 30 P. (2d) 956 (1934), cited by appellee, do not involve a question of modification.

REPLY ARGUMENT ON SPECIFICATION OF ERROR NO. 3

Under this heading, appellant argued that the agreement of July, 1951, constituted an accord and

satisfaction of all matters arising out of appellee's employment, and that he is now estopped from asserting the claim in suit.

Appellee's answering argument avoids the questions raised under this heading by convenient distortion and assumptions with regard to appellant's position. It will therefore be restated:

> 1. Appellant was entitled to terminate appellee's services in July, 1951; in fact, at any time subsequent to May, 1949.
>
> 2. The parties reached an agreement under which appellee received compensation for a period of six months beyond that proposed by appellant.
>
> 3. Appellee manifested apparent assent to the agreement as a complete settlement of all matters arising out of his employment. He affirmatively relied upon his reduction in commissions in urging that he receive compensation beyond September, 1951.
>
> 4. Appellant fully performed the July, 1951 agreement and the evidence is clear that appellee then believed and led appellant to believe that its performance was a complete satisfaction of any and all his claims ,and appellee must have known that appellant so understood.

There is no room for dispute that appellee could have been discharged immediately in July, 1951. It is immaterial for these purposes whether this is because his services were unsatisfactory, or because he had breached his contract, or because the contract was terminable at will, or because it was void under the Statute of Frauds.

That being the case, appellant's payment of com-

pensation to appellee for the period through February 29, 1952, constituted abundant consideration for an accord and satisfaction. Appellant concedes that consideration is necessary for a binding accord and satisfaction, and has no argument with the numerous authorities to that effect cited by appellee.

It therefore becomes material to determine whether the agreement of July, 1951, under which appellee continued to receive compensation through February, 1952, was intended to be in final settlement of all the mutual obligations of the parties arising out of appellee's employment.

In July, 1951, appellant desired to terminate appellee's employment effective September 1, 1951, because of his interest in California Paperboard Company. In that state of affairs, appellee wrote appellant's president under date of July 12, 1951 (Ex. A-2). He reviewed his activity on behalf of appellant and proposed December 31, 1952, as the date for termination of his employment. In urging his continued employment until that date, he wrote as follows:

> "As you know I voluntarily reduced my sales commission from 3% to 1½" *in January of* 1950. This 'till now covers an eighteen month period and the next eighteen months on the same basis brings up the proposed termination date." (The italics phrase should read "1½% in January of 1949" (Tr. 123-24).

* * *

> "This proposal of mine is what I would consider to be the bare minimum in a separation arrangement with this company . . ."

Appellant does not contend that when appellee's separation, and compensation through February 29, 1952, was agreed upon in July, 1951, appellee expressly renounced any claim to recover additional commissions at the rate of 1½% from January 1, 1949. Appellant did not know he had any such claim. Appellee had advanced his earlier voluntary reduction as a contention in favor of his retention beyond the date contemplated by appellant.

Appellee now contends that he did not intend to relinquish his right to 1½% additional commission from January, 1949. Appellee's position therefore must be that where two parties fully compromise and settle their mutual obligations, one of them remains free at a future time to recover on a claim which existed at the time of the settlement, merely because it was not disclosed to the other party. Appellant's case of *Austin v. Union Lumber Company,* 95 Wash. 608, 164 Pac. 245 (1917), original brief, pp. 32-33, is a complete answer to appellee's contentions.

Appellee seeks to avoid the only reasonable construction of the words and conduct of the parties in July, 1951, by asserting that he did not intend to relinquish his claim for additional compensation, and that "there can be no accord and satisfaction

without a meeting of the minds and a specific mutual intention to settle a disputed claim." (Brief, 23)

The difficulty is that appellee's intention as to the meaning and effect of the July, 1951, agreement is determined by his "outward expressions and acts" rather than his secret mental reservations. 12 Am. Jur. "Contracts," Sec. 19, p. 516.

In 3 *Williston on Contracts* (Rev. Ed.), Sec. 681, p. 1967, it is said, on the question of intent of the parties, where there is a claim of waiver based on an accord and satisfaction:

> "There must be a manifestation of mutual assent, but the actual mental intent is immaterial. When a case of surrendering a right by a new contract is presented where the apparent intent differs from the actual intent, the apparent intent controls."

The Washington Supreme Court has characterized conduct by an employee substantially similar to appellee's conduct here as a "furtive attempt" to fasten liability on the employer which it would not countenance. *Herman v. Golden Arrow Dairy, Inc.*, 191 Wash. 582, 586, 71 P. (2d) 581 (1937). There, Herman was employed by the dairy at the union wage scale, which provided additional pay for overtime work. After the termination of his employment, he sued to recover sums claimed due him, including overtime payments. He had accepted his monthly wages during his employment without disclosing any claim to overtime, until suit was filed.

The Court assumed that he was entitled to overtime payments under the terms of his contract, but held his conduct estopped him from claiming compensation for it.

See also *Yanoscheck v. Montgomery Ward & Co.*, 176 Wash. 137, 28 P. (2d) 270 (1934).

It would be strange if the law permitted a party to negotiate for and receive additional compensation, partly on the basis of a prior reduction in that compensation, and after receiving and accepting the benefits of his bargain, go back and recover on a claim such as this, because he had his fingers crossed at the time of the agreement. It is submitted that appellee's position is wholly without support.

Appellee's conduct subsequent to the July, 1951, agreement is equally inconsistent with any right now to recover additional compensation from January, 1949. See original brief, pp. 9-10.

Appellee's reliance on *Bellingham Securities Syndicate v. Bellingham Coal Mines,* 13 Wn. (2d) 370, 125 P. (2d) 668 (1942), and other cases cited on pages 20 and 21 of his brief, is misplaced. In that case there was no dispute and no attempted settlement. The debtor merely paid what it admitted it owed, and the creditor accepted it.

Unlike *Ingram v. Sauset,* 121 Wash. 444, 209 Pac. 699 (1922), here the evidence makes clear that appellant's agreement to pay and payment of compensation through February, 1952, was intended to be

in full satisfaction of any claim arising out of appellee's employment, that appellee knew appellant's intention and understanding, and requested and received the payments, including the "final check" with that understanding.

Appellee's claim that appellant did not incur the detriment prerequisite to an estoppel ignores the fact that appellee could have been discharged in July and appellant was under no obligation to pay appellee for any period after September, 1951. In effect, appellant granted appellee six months' severance pay in excess of $11,500.00 (Ex. C to Conclusions of Law, Tr. 43) as an arrangment for his separation.

REPLY ARGUMENT ON SPECIFICATION OF ERROR NO. 4

Appellant's statement in its original brief, page 2, that it pleaded the Statute of Frauds as an affirmative defense was in error as correctly pointed out by appellee. Paragraph II of appellant's answer, however, denied "that the said contract was in writing." (Tr. 19) Appellee concedes that a general denial raises the issue of the Statute of Frauds, but argues that a special denial that the contract was in writing fails to do so. No authority is cited.

Moreover, if the Statute of Frauds was not sufficiently raised by this specific denial, the answer was nevertheless treated as amended to plead it as an affirmative defense by the trial court, which

referred to it as an affirmative defense in its Finding of Fact XIV (Tr. 41).

CONCLUSION

Appellant submits that reversal of this judgment is required by the evidence and the law.

In barest outline, appellee's employment agreement was modified, as to future commissions, by a voluntary reduction until the operation became profitable. There was no testimony from which it could be inferred that collection of the balance was to be postponed, and no effort to show that the operation did become profitable.

The trial court's finding that collection of the balance was "in effect" postponed can only have been a legal conclusion based on an erroneous view of Washington law, which holds that no fresh consideration is necessary for the binding modification of a contract which remains executory in a substantial measure.

Finally, appellee's secret or as yet unformed intention in July, 1951, to claim additional compensation from January, 1949, forward, cannot be given legal effect to the exclusion of his outward expressions and conduct at that time and subsequent thereto, so as to prevent the apparent agreement from constituting an accord and satisfaction, and his acceptance of appellant's performance estops him from asserting the claim in suit.

BRIEF ON CROSS-APPEAL

ARGUMENT

Appellee presented Conclusions of Law and a judgment providing for the payment of interest on each unpaid monthly amount allegedly due appellee as it accrued (Tr. 42-43, 46). In other words, appellee claimed interest on the 1½% claimed to have been unpaid for the month of January, 1949, from that month.

Accepting for the purpose of this question all Findings and Conclusions of the trial court, clearly no interest was payable. Appellee's testimony was:

> "* * * as a temporary measure I would reduce the commission to one and one-half percent until the operation became profitable." (Tr. 97)
>
> * * *
>
> "Q. (By Mr. Evans): On January 1, 1949, you were agreeable to receiving one and one-half percent commission — at least for that month—rather than three percent? A. Yes." (Tr. 109)
>
> * * *
>
> "Q. Now, you made no demand on anybody for this additional one and one-half percent—at least up until the time you terminated your employment—did you? A. Not a demand, no." (Tr. 110)

The trial court found that appellee advised appellant ". . . that he would temporarily reduce his commission to 1½% . . . and would in effect, postpone collection of the remainder thereof." (Finding of

Fact No. X, Tr. 38) Appellee presented this Finding and took no exception thereto.

Appellee having voluntarily "postponed" collection of a part of his compensation, and having been willing to accept 1½% for the month of January, 1949, it is clear that the claimed balance of his compensation was *not* due in that month, and no interest became payable.

No case cited by appellee holds that interest is payable on an amount before it becomes due, in the absence of an agreement to pay interest.

> "In the absence of any contract to the contrary, interest on money becomes due and payable only when the money becomes due and payable." *Herzog v. Herzog,* 23 Wn. (2d) 382, 387, 161 P. (2d) 142 (1945).

In *Washington Fish & Oyster Co., Inc. v. G. P. Halferty & Co., Inc.,* 44 Wn. (2d) 646, 269 P. (2d) 806 (1954), the plaintiff recovered the balance of the purchase price due on a sale of canned salmon. Under the sale contract, payment was due when the various shipments of salmon arrived at destination. The plaintiff failed to show these dates, and the Washington Supreme Court reversed the judgment of the trial court which had awarded interest from the date of the last shipment. It held there was a failure of proof as to the time the principal became due, and, under the law of Washington, interest could not be allowed.

The situation in this case is identical. Here the

trial court found the plaintiff entitled to recover, but since he failed to prove when the principal became due, he is not entitled to interest.

It must also be remembered that the agreement of January, 1949, by which appellee "postponed" collection of a part of his commission, was made at a time when no commissions were due and payable by appellant to appellee.

Here there is no contention that the parties contracted for the payment of interest on the "postponed" portion of appellee's compensation or that appellant breached its agreement by not continuing to pay appellee at the rate of 3% each month despite his "voluntary reduction," and consequently no basis upon which an obligation to pay such interest can be imposed.

Respectfully submitted,

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